DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Number: **200452036**
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Date: SEP 29, 2004

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

Legend:
L=
M=
N=
O=
T=
U=
W=
Y=
B=
C=
D=
E=
F=
G=

Dear :

We have considered your application for recognition of exemption from federal income tax under section 501(c)(3) of the Internal Revenue Code as an organization described in section 501(c)(3). Based on the information submitted, we conclude that you do not qualify for exemption under that section. Moreover, you do not meet the requirements necessary for recognition of exemption under section 501(c)(4). The basis for our conclusion is set forth below.

You were incorporated on . Your amended Articles of Incorporation indicate that your purposes are as follows: "To operate and act exclusively for charitable, educational, religious, literary or scientific purposes and/or to lessen the financial burdens of government by providing consumer debt consolidation services." Your Articles of Incorporation do not contain specific language limiting your purposes to educational or charitable purposes, as described under section 501(c)(3) of the Code, nor do you have a dissolution clause, which would limit the distribution of your assets to 501(c)(3) purposes or to other organizations described under section 501(c)(3). On your Website, you make the following statement in describing the nature of your services: "M is a nonprofit debt management service. We assist consumers with budget planning and credit counseling. Our staff has many years of combined experience in the financial services industry. We provide a professional, confidential service."

Your Board of Directors consists of B, C, D, E and F. You stated, in your Application, that B will receive in compensation for service on the Board, and that D will receive for service on the Board. You further stated that F is the father of G, from whom you rent office space. You have submitted an independent assessment of the office space, indicating that you pay above market rent for this space. You provided no evidence that you considered other sources for rental of office space.

Information obtained from you and from over the internet, indicates that G has an ownership interest in L, a for-profit company. The information states that G is the president of L. The information further reveals that your actual address of operation is in the same location as L. Furthermore, we are in possession of information that L has been the subject of a citation, issued by the Federal Communications Commission, for violations of certain rules governing telephone solicitation. L is also apparently the subject of a civil complaint filed by a state Attorney General against L and two other companies accusing them of operating a fraudulent loan scheme targeting low income borrowers.

In a letter to you dated August 9, 2004, we requested that you provide additional information regarding any relationships you may have with L, including any financial dealings, copies of any agreements entered into with G, any sharing of administrative staff, and proof that your operations, directly or indirectly, are not affiliated with L. Your responses, in your letter dated September 16, 2004, were either incomplete or non-responsive.

The resumes you provided for B and D indicate that they are employed by N, a for-profit company, from which you intend to obtain services in staffing, training, advertising, software, database management and web-development, during your "start-up" phase of operations. You do not mention how long you expect your "start-up" phase to last, nor do you indicate the amount of salary to be paid by N to D and B. Moreover, none of your Board members, including D and B have any extensive prior work experience or educational background in nonprofit "credit counseling."

The initial term of the "Agreement to Provide Services" is 18 months and may be extended

at any time by mutual agreement of the parties. Pursuant to the agreement you will pay N periodically for advertising at cost plus percent ( ) and for all other services provided at cost, including but not limited to actual direct labor costs, rent, utilities, telephone, printing and postage." Because you apparently do not have employees of your own, we presume that you are referring to N's employees wherever applicable.

The agreement also provides that "in consideration of one dollar ($1.00), during the initial term, N hereby agrees to establish and maintain on behalf of M a database of the accounts M agrees not to share or copy or distribute the N database. M and N hereby acknowledge and agree that N shall retain ownership of the entire worldwide present and future right, title, and interest (including all patent rights, copyrights, trade secret rights, and other intellectual property rights) in and to any and all Developments related to the database or Service provided to M. For purposes of this Agreement, "Development" means any idea, invention, discovery, design (whether the design is ornamental or otherwise), computer program or code and related documentation, and all other works of authorship."

You entered into an agreement with O, a for-profit company, for the provision of electronic transfer program services. O will, with your client's authorization, debit the client's checking or savings account for the amount owed to you by the client. Under the agreement, you have agreed to pay O on a monthly basis, by a debit to your account for these service charges. You also agreed to pay any taxes for which you would be liable, not including any taxes for which O would otherwise be liable to pay. You have not indicated the amount of your monthly fee to be paid to O.

You indicated that your employees are "charged with providing financial counseling and setting up debt management programs for consumers. You state that these employees will do a complete review of a consumer's finances as well as obtain any and all credit information for debt management programs. (DMP) These employees will also assist customers with any and all problems or assistance needed with the DMP." You have stated that employees' starting salaries will be , with health insurance after 90 days of employment. Education requirements will include at minimum an Associates Degree or "equivalent customer service experience." You will also require that employees become certified within 6 months by T, a private certification agency.

You have stated that employees in your accounting and disbursement services department are "charged with disbursement of consumer payments to creditors, accounting, coding clients, fair share billing to creditors, client correspondence, proposal submission to creditor, creditor correspondence & communication." These employees will also be responsible for payroll and human resources. You indicated that these individuals will be paid a starting salary of , with health insurance after 90 days of employment. Education requirements will include at minimum an Associates Degree or "equivalent accounting/related experience."

Your technical employees will be "charged with database management, computer networking, programming and software." These employees will receive a starting salary of

, with health insurance after 90 days of employment. Education requirements include "4 years minimum network experience, Microsoft certified."

In a letter dated February 5, 2004, you represented the following with regard to your employees: "Currently, the Corporation employs ( ) full-time employees, ( ) of whom provide counseling and education services, ( ) of whom provide debt consolidation services, and ( ) of whom provide administrative and database management services. On average, the Corporation's employees provide approximately hours of counseling and education services, and approximately hours of debt consolidation services."

You have represented, in your Application, that of "the 60% Educational and Client Services referred to in 1023 Part II question 1, 40% of this is educational." You further stated the following: "Of the 60% Educational and Client Services referred to in 1023 Part II question 1, 20% on debt/repayment program." Moreover, in a letter dated August 7, 2003, you stated the following: "With the benefit of of operation, it is clear that such percentage allocations require refinement. In the interim since submission of the Application, the credit counseling staff has grown considerably and far out numbers the accounting and administrative staff of the organization. Therefore, the percentage of time reported in the original Application of 60% for education and client counseling services is actually higher at this point in time. As the client base grows, the organization anticipates the percentage further increasing." In the August 7, 2003 letter, you did not provide information on actual or estimated changes in the percentage of time dedicated to education and client counseling services.

With regard to your education/counseling activities, you stated the following in your Application: "Credit counselors are available to speak with consumers Monday through Saturday in person or by telephone. Educating consumers about their credit and budget planning is the primary focus of this department. Information manuals are distributed by this department and are available to the organizations clients and general public free of charge. All counseling is done by telephone. This activity will begin in . We anticipate the offering of seminars by the fall of . A quarterly newsletter is anticipated by . All activity in this department is designed for the express purpose of educating the public." We note that in your sample script, you stated the following with regard to what a consumer should look for in a debt consolidation agency: "When a consumer considers debt consolidation they should first understand how the process works. Our job as a debt consolidation agency is to educate the public about our service."

You have provided sample copies of educational materials (that you state are produced in house by your personnel), which you distribute to clients and the general public. These materials include booklets, which cover a variety of credit topics such as: "Understanding How to Consolidate Credit Cards and Other Unsecured Debts in Credit Counseling" (pages); "Understanding Household Budgets, Credit Cards and Electronic Banking" (pages); "Financial Basics" (pages); "What You Should Know-Informative Articles for Consumers" (

pages); and "Consumer Protection Acts" (pages). You did not provide a detailed explanation of when, where, or how these materials would be used in educating clients and the

general public. You did provide a copy of the "Certification Exam Study Manual" to be used by your employees in preparing for the T counseling examination. You have not provided any evidence that your employees have in fact taken and passed this examination.

You have indicated that your primary method for soliciting potential clients for your DMP program is through the use of leads. With regard to leads you have made the following representation: "Leads cost derived through email services can range from to per lead. M purchases approximately leads per month from unaffiliated Email vendors, this makes up our ad budget. These leads consist of consumers showing interest in debt management services." Moreover, your use of your website as a means to advertise and attract potential clients is reflected in the following statements on the website: "

You have even made the following representation to potential clients:

You have stated that after making contact with a potential client the following occurs: "An assessment of the consumer's financial situation and current needs is done. If appropriate the Debt Management Program (DMP) is explained to the consumer. A detailed list of the consumer's un-secured debt is entered into our computer, which calculated a monthly payment based on the individual requirements of each creditor. A financial analysis is done including a consumer's net income and monthly expenses. After all information is evaluated a consumer can be given a monthly payment requirement for the DMP. If the consumer would like to proceed they are given an agreement outlining the program and monthly payment. Once a payment date is agreed on, the consumer is advised to verify with each creditor that the balances are correct; a verification form is filled out by the consumer and given to the counselor. Consumers are advised to stay in close contact with counselor as the accounts are being set up in the DMP with the creditors. Counselors are available over the phone or in person throughout the consolidation. Monthly statements are mailed to the consumer." We note that in your sample script, on page two, you offer potential clients a "Credit Counseling Care Insurance Plan." The plan claims to be underwritten by U, and only costs per month, and covers the client in the event of death, disability or unemployment. It will allegedly pay off debt up to . You have not provided any written evidence (contract, etc.) that you in fact have an agreement with U to provide the aforementioned insurance coverage to your clients.

With regard to the amount clients' pay to use your DMP services, you stated that your "fees are all voluntary. We charge no required fees." However, our review of the information you provided, including the "Debt Consolidation Services Agreement," shows that these "voluntary" contributions are in fact fees paid by clients in exchange for your DMP services. Information provided indicates that your fees are on a sliding scale and can range up to per month per account. You have indicated that set-up fees are per client. Although you have said you would waive the fee for those unable to pay, you have provided no evidence that you have ever done so. The Services Agreement also includes

Under the terms and conditions of the Services Agreement, you made the following statement:

Moreover, the Services Agreement states the following with regard to terminating a client from the DMP program: “If a monthly payment is not received when due, M may assume that the CLIENT has discontinued the PROGRAM and M may, at its discretion, be relieved of further responsibility to CLIENT. CLIENT will remain liable for any outstanding balances to creditors.” We note that the Services Agreement does not allow for a lump sum payment to creditors in paying off a client’s debt; that a client’s finances can be revealed to third parties at your discretion; and if a creditor requires a client to pay more than the proposed payment, the client’s monthly payment will be increased.

In your letter dated February 5, 2004, you stated the following with regard to your DMP program: “For , the total individuals enrolled in debt consolidation services were . To ensure the highest level of service, the Board of Directors has decided to cap the number of monthly enrollees, and it will not exceed per month. For the fiscal year ending , the Corporation projects it will establish to new accounts under the debt consolidation program, with a total of approximately .

You have indicated that your other source of income will come from a “fair-share” program. You have not provided specific details (including contractual arrangements) of how the program would operate; however, in your letter dated February 5, 2004, you stated the following: “For the fiscal years ending and (projected

In your Application, you provided proposed budgets for and . For the year , you show revenue in the amount of ; your expenses include in salaries and wages and compensation to officers, in program services, and excess revenue of . For the year , you show revenue in the amount of ; your expenses include in salaries and wages and compensation to officers, in program services, and in excess revenue. You have not provided information as to the specific amount(s) paid to each company from which you purchased a particular program-related service. However, you do indicate that you have designated in program service revenue to the purchase of leads from various unidentified, “unaffiliated Email vendors.” You have provided a copy of your business license issued for by the city of W. You have provided proof of a bond for credit counseling to be conducted in the state of Y, but you have not shown that you have a bond for credit counseling conducted in your present location.

Moreover, you have not shown any specific designation of revenue to educational programs directed to the general community, or to grants, gifts or contributions to charitable organizations. Your sole source of revenue will be derived from fees associated with your DMP program and fees to be collected from creditors participating in your "fair share" program.

Section 501(c)(3) of the Code exempts from federal income tax corporations organized and operated exclusively for charitable, educational, and other purposes, provided that no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that, in order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(b)(1)(i) of the regulations provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization:

(a) Limit the purposes of such organization to one or more exempt purposes; and
(b) Do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities that in themselves are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(c)(2) of the regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. Section 1.501(a)-1(c) defines the words "private shareholder or individual" in section 501 to refer to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, to meet the requirements of this subsection, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense and includes relief of the poor and distressed or of the under privileged as well as the advancement of education.

Section 1.501(c)(3)-1(d)(3) of the regulations provides that the term "educational" refers to:

(a) The instruction or training of the individual for the purpose of improving or developing his capabilities; or
(b) The instruction of the public on subjects useful to the individual and beneficial to the community.

Section 1.501(c)(3)-1(e)(1) of the regulations provides that an organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purposes of carrying on an unrelated trade or business.

In Rev. Rul. 69-441, 1969-2 C.B. 115, the Service found that a nonprofit organization formed to help reduce personal bankruptcy by informing the public on personal money management and aiding low-income individuals and families with financial problems was exempt under section 501(c)(3) of the Code. Its Board of Directors was comprised of representatives from religious organizations, civic groups, labor unions, business groups, and educational institutions.

The organization provided information to the public on budgeting, buying practices, and the sound use of consumer credit through the use of films, speakers, and publications. It aided low-income individuals and families who have financial problems by providing them with individual counseling, and if necessary, by establishing budget plans. Under the budget plan, the debtor voluntarily made fixed payments to the organization, which held the funds in a trust account and disbursed the funds on a partial payment basis to the creditors. The organization did not charge fees for counseling services or proration services. The debtor received full credit against his debts for all amounts paid. The organization did not make loans to debtors or negotiate loans on their behalf. Finally, the organization relied upon voluntary contributions, primarily from the creditors participating in the organization's budget plans, for its support.

The Service found that, by aiding low-income individuals and families who have financial problems and by providing, without charge, counseling and a means for the orderly discharge of indebtedness, the organization was relieving the poor and distressed. Moreover, by providing the public with information on budgeting, buying practices, and the sound use of consumer credit, the organization was instructing the public on subjects useful to the individual and beneficial to the community. Thus, the organization was exempt from federal income tax under section 501(c)(3) of the Code.

Rev. Rul. 71-529, 1971-2 C.B. 234, held that a nonprofit organization providing assistance in the management of participating colleges' and universities' endowment or investment funds for a charge substantially below cost qualified for exemption under section 501(c)(3) of the Code. Most of the operating expenses of the organization, including the costs of the services of the investment counselors and the custodian banks, were paid for by grants from independent charitable organizations. The member organizations paid only a nominal fee

for the services performed. These fees represented less than 15 percent of the total costs of the operation. By performing these services for a charge substantially below its cost, the organization was performing a charitable activity for purposes of section 501(c)(3) of the Code.

Rev. Rul. 72-369, 1972-2 C.B. 245, held that an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations did not qualify for exemption under section 501(c)(3) of the Code. Providing managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit. The fact that the services were provided at cost and solely for exempt organizations was not sufficient to characterize the activity as charitable for purposes of section 501(c)(3) of the Code. "Furnishing the services at cost lacks the donative element necessary to establish this activity as charitable."

Rev. Rul. 76-244, 1976-1 C.B. 155 , held that home delivery of meals to the elderly free or with charges on a sliding scale, depending on recipients' ability to pay, is a charitable purpose.

Rev. Rul. 78-99, 1978-1 C.B. 152, held that the provision of individual and group counseling for widows based on their ability to pay is an educational activity.

Rev. Proc. 90-27, 1990-1 C.B. 514, provides in part, that exempt status will be recognized in advance of operations if proposed operations can be described in sufficient detail to permit a conclusion that the organization will clearly meet the particular requirements of the section under which exemption is claimed. A mere statement of purposes or a statement that proposed activities will be in furtherance of such purposes will not satisfy this requirement. The organization must fully describe the activities in which it expects to engage, including the standards, criteria, procedures, or other means adopted or planned, and the nature of the contemplated expenditures. Where the organization cannot demonstrate to the satisfaction of the Service that its proposed activities will be exempt, a record of actual operations may be required before a ruling or determination letter will be issued.

An organization must establish through the administrative record that it operates as a section 501(c)(3) organization. Denial of exemption may be based solely upon failure to provide information describing in adequate detail how the operational test will be met. American Science Foundation v. Commissioner, T.C. Memo. 1986-556; La Verdad v. Commissioner, 82 T.C. 215, 219 (1984); Pius XII Academy v. Commissioner, T.C. Memo. 1982-97. Exempt status can be recognized in advance of operations if proposed operations can be described in enough detail to permit a conclusion that the organization will clearly meet the requirements of section 501(c)(3). American Science Foundation v. Commissioner, T.C. Memo. 1986-556.

In Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purposes, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes.

In The Founding Church of Scientology v. U.S, 188 Ct. Cl. 490, 506 (1969), the Court of Claims found as a damaging fact that one of the reasons Scientology was organized as a

religion was to evade regulation, as one state was investigating Scientology for operating a medical school without a license.

In Consumer Credit Counseling Service of Alabama, Inc. v. United States, 78-2 U.S.T.C. 9660 (D.D.C. 1978), the court held an organization that provided free information on budgeting, buying practices, and the sound use of consumer credit qualified for exemption from income tax because its activities were charitable and educational.

The Consumer Credit Counseling Service, which has been recognized as exempt under section 501(c)(3) in a group ruling, is an umbrella organization made up of numerous credit counseling service agencies. In this case, these agencies provided information to the general public through the use of speakers, films, and publications on the subjects of budgeting, buying practices, and the sound use of consumer credit. They also provided counseling on budgeting and the appropriate use of consumer credit to debt-distressed individuals and families. They did not limit these services to low-income individuals and families, but they provided such services free of charge. As an adjunct to the counseling function, they offered a payment plan. Approximately 12 percent of a professional counselor's time was applied to the payment activity as opposed to an educational activity. Moreover, the agencies only charged a nominal fee of up to $10 per month for this service.. This fee was waived in instances when payment of the fee would work a financial hardship.

The agencies received the bulk of their support from government and private foundation grants, contributions, and assistance from labor agencies and the United Way. An incidental amount of their revenue was from counseling fees. In 1974, the Service ruled that each of the agencies constituted organizations described in section 501(c)(3). However, two years later, the Service notified the agencies that it had made a mistake and was reclassifying them under section 501(c)(4). The reasons given by the Service for revocation of section 501(c)(3) were that: (1) the agencies were not organized and operated exclusively for charitable or educational purposes; (2) the debt management service is not limited to low-income individuals or families; and (3) fees are charged for the services rendered.

The court did not agree with the Service and directed verdicts for the plaintiff. Providing information regarding the sound use of consumer credit is charitable because it advances and promotes education and social welfare. These programs were also educational because they instructed the public on subjects useful to the individual and beneficial to the community. The counseling assistance programs were likewise charitable and educational in nature. Because the community education and counseling assistance programs were the agencies' primary activities, the agencies were organized and operated for charitable and educational purposes. The limited debt management and creditor intercession activities were an integral part of the agencies' counseling function, and thus were charitable and educational undertakings. Even if this were not the case, these activities were incidental to the agencies' principal functions.

Finally, the court found that the law did not require that an organization must perform its exempt functions solely for the benefit of low-income individuals to qualify under section 501(c)(3). Nonetheless, the agencies did not charge a fee for the programs that constituted

their principal activities. A fee may be charged for a service that was an incidental part of an agency's function, but even when a fee was so charged, it was nominal. Moreover, even this nominal fee was waived when payment would work a financial hardship. Thus, the court ordered that "each of the plaintiff consumer credit counseling agencies was an organization described in section 501(c)(3) as a charitable and educational organization." See also, Credit Counseling Centers of Oklahoma, Inc. v. United States, 79-2 U.S.T.C. 9468 (D.D.C. 1979), in which the facts were virtually identical and the law was identical to those in the case styled Consumer Credit Counseling Centers of Alabama, Inc. v. United States, discussed immediately above. Thus, the court ordered that the consumer credit counseling agencies were described in section 501(c)(3) as charitable and educational organizations.

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the court found that a corporation formed to provide consulting services was not exempt under section 501(c)(3) because its activities constituted the conduct of a trade or business that is ordinarily carried on by commercial ventures organized for profit. Its primary purpose was not charitable, educational, nor scientific, but rather commercial.

The court found that the corporation had completely failed to demonstrate that its services were not in competition with commercial businesses. The court found that the organization's financing did not resemble that of the typical 501(c)(3) organization. It had not solicited, nor had it received, voluntary contributions from the public. Its only source of income was from fees from services, and those fees were set high enough to recoup all projected costs, and to produce a profit. Moreover, it did not appear that the corporation ever planned to charge a fee less than "cost." And finally, the corporation had failed to limit its clientele to organizations that were section 501(c)(3) exempt organizations.

The Court in est of Hawaii v. Commissioner, 71 T.C. 1067 (March 28, 1979) found that an organization formed to educate people in Hawaii in the theory and practice of "est" was a part of a "franchise system which is operated for private benefit," and therefore may not be recognized as exempt under section 501(c)(3) of the Code. The applicant for exempt status was not formally controlled by the same individuals controlling the for-profit organization owning the license to the est body of knowledge, publications, methods, etc. However, the for-profit exerted "considerable control" over the applicant's activities by setting pricing, the number and frequency of different kinds of seminars and training, and providing the trainers and management personnel who are responsible to it in addition to setting price for the training. The court found that the fact that the applicant's rights were dependent upon its tax-exempt status showed the likelihood that the for-profit corporations were trading on that status. The question for the court was not whether the payments made to the for-profit were excessive, but whether it benefited substantially from the operation of the applicant. The court determined that there was a substantial private benefit because the applicant "was simply the instrument to subsidize the for-profit corporations and not vice versa and had no life independent of those corporations.

In P.L.L. Scholarship v. Commissioner, 82 T.C. (1984), an organization operated bingo at a bar for the avowed purpose of raising money for scholarships. The board included the bar owners, the bar's accountant, also a director of the bar, as well as two players. The board was

self-perpetuating. The court reasoned that, because the bar owners controlled the organization and appointed the organization's directors, the activities of the organization could be used to the advantage of the bar owners. The organization claimed that it was independent because there was separate accounting and no payments were going to the bar. The court was not persuaded.

> A realistic look at the operations of these two entities, however, shows that the activities of the taxpayer and the Pastime Lounge were so interrelated as to be functionally inseparable. Separate accountings of receipts and disbursements do not change that fact.

The court went on to conclude that, because the record did not show that the organization was operated for exempt purposes, but rather indicates that it benefited private interests, exemption was properly denied.

In St. Louis Science Fiction Limited v. Commissioner, T.C. Memo 1985-162, April 2, 1985, the Court reviewed the annual convention of a science fiction organization. It held that while the conventions may have provided some educational benefit to some of the individuals involved, that social and recreational purposes, and private benefit predominated. The Court distinguished Goldsboro Art League, Inc. v. Commissioner, 75 T.C. 337 (1980) in which the organization provided public art education by using juries to insure artistic quality and integrity.

> Petitioner relies heavily upon Goldsboro Art League, Inc. v. Commissioner, 75 T.C. 337 (1980), in support of its contention that it is tax-exempt. In Goldsboro Art League, the taxpayer was an organization that operated two art galleries that exhibited and sold artworks. We held that the taxpayer was tax-exempt under section 501(c)(3) because it was organized and operated exclusively for an exempt purpose--art education. We noted that in order to insure artistic quality and integrity, the artworks displayed were selected by jury procedures. We also noted that the taxpayer was the only such museum or gallery within its county, or any contiguous county. We held that it served public, rather than private interests and that its sales activities were incidental to advancing its exempt purpose. By contrast, petitioner in this case did not apply any controls to insure the quality of the books and artworks sold at its convention. Also, the tone of petitioner's convention is substantially, if not predominantly, social and recreational, rather than educational. In addition, petitioner's huckster's room and art auction provided substantial benefit to private interests that is not incidental to its exempt purpose. Consequently, we think the case Goldsboro Art League is clearly distinguishable on its facts from the instant case.

In Church By Mail, Inc. v. Commissioner, T.C. Memo 1984-349, *aff'd* 765 F. 2d 1387 (9th Cir. 1985) the tax court found that a church was operated with a substantial purpose of providing a market for an advertising and mailing company owned by the same people who controlled the church. The church argued that the contracts between the two were reasonable, but the Court of Appeals pointed out that "the critical inquiry is not whether particular contractual payments to a related for-profit organization are reasonable or excessive, but instead whether the entire enterprise is carried on in such a manner that the for-profit organization benefits substantially from the operation of the Church."

In Easter House v. United States, 846 F. 2d 78 (Fed. Cir. 1988), aff'g 12 Cl. Ct. 476 (1987), the court found an organization that operated an adoption agency was not exempt under section 501(c)(3) of the Code because a substantial purpose of the adoption activity was a non-exempt commercial purpose. It found that the adoption services did not further the exempt purposes of providing educational and charitable services to the unwed mothers and children. Rather, the services for unwed mothers and children were merely provided "incident" to the organization's adoption service business. Moreover, the court found that "adoption services do not in of themselves constitute an exempt purpose."

The court agreed with the IRS' determination that the agency operated in a manner not "distinguishable from a commercial adoption agency." First, the agency's operation made substantial profits, and there was a substantial accumulation of capital surplus in comparison to direct expenditures by the agency for charitable and educational purposes. Second, the agency's operation was funded completely by substantial fixed fees charged adoptive parents. It relied entirely on those fees and sought no funds from federal, state or local sources, nor engaged in fund raising programs, nor did it solicit contributions. In fact, the agency had no plans, nor intention to seek contributions, government grants or engage in fund raising relative to its operations. Third, the fixed fees the agency charged adoptive parents were not subject to downward adjustment to meet potential adoptive parents' income or ability to pay. Fourth, the agency's membership was organized into classes of memberships, single life member, member and ordinary member. And fifth, the agency functions by means of a paid staff of 15 to 20 persons, with no volunteer help.

In International Postgraduate Medical Foundation v. Commissioner, T.C. Memo 1989-36, the court found an organization that ran tours aimed at doctors and their families was operated to benefit the private interests of an individual who controlled the organization and a for-profit travel agency (H&C Tours) that handled all of its tour arrangements.

The organization used the H&C Tours exclusively for all travel arrangements. There was no evidence that the organization solicited competitive bids from any travel agency for travel arrangements for its tours other than H&C Tours. The organization physically located its office within the offices of H&C Tours, which provided it secretarial, clerical, and administrative personnel for a fee equal to H&C Tours' costs. The organization spent 90 percent of its revenue on travel brochures prepared to solicit customers for tours arranged by the travel agency. The brochures emphasized the sightseeing and recreational component of the tours, but did not describe the medical curriculum for the seminars and symposia that was the basis for exemption. Educational activities occurred on less than one-half of the days on a typical tour.

The court found that a substantial purpose of the organization's operations was to increase the income of H&C Tours. The president of H&C Tours controlled the organization and exercised that control for the benefit of H&C Tours. Moreover, the administrative record supported the finding that the organization was formed to obtain customers for H&C Tours.

In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C., 2003), the court relied on the "commerciality" doctrine in applying the operational test. Because of the commercial

manner in which an organization conducted its activities, courts have found that an organization was operated for a non-exempt commercial purpose, rather than for a tax-exempt purpose. "Among the major factors courts have considered in assessing commerciality are competition with for profit commercial entities; extent and degree of below cost services provided; pricing policies; and reasonableness of financial reserves. Additional factors include, *inter alia,* whether the organization uses commercial promotional methods (e.g. advertising) and the extent to which the organization receives charitable donations."

The court maintained that, if private individuals or for-profit entities have either formal or effective control of a non-profit organization, it was presumed that the organization furthered the profit-seeking motivations of those private individuals or entities. This was the case, even when the organization was a partnership between a non-profit and a for-profit entity. (citing Redlands Surgical Services v. Commissioner, 113 T.C. 47 (1999)).

The Credit Repair Organizations Act ("CROA"), 15 U.S.C. section 1679 et seq., effective April 1, 1997, imposes restrictions on credit repair organizations, including forbidding the making of untrue or misleading statements and forbidding advance payment, before services are fully performed. 15 U.S.C. section 1679b. Section 501(c)(3) organizations are by definition excluded from regulation under the CROA. The CROA defines a credit repair organization as:

> (A) any person who uses any instrumentality of interstate commerce or the mails to sell, provide, or perform (or represent that such person can or will sell, provide, or perform) any service, in return for the payment of money or other valuable consideration, for the express or implied purpose of—
>
> (i) improving any consumer's credit record, credit history, or credit rating, or
> (ii) providing advice or assistance to any consumer with regard to any activity or service described in clause (i).

15 U.S.C. section 1679a(3). The courts have interpreted this definition broadly to apply to credit counseling agencies. The Federal Trade Commission's policy is that if an entity communicates with consumers in any way about the consumers' credit situation, it is providing a service covered by the CROA. In Re National Credit Management Group, LLC, 21 F. Supp. 2d 424, 458 (N.D.N.J. 1998).

In FTC v. Gill, 265 F.3d 944 (9th Cir. 2001), aff'g 183 F. Supp. 2d 1171 (2001), the appellate court inferred that a credit repair organization that first promised a "free consultation," but charged fees in advance of the full performance of services was being subsequently operated as a charity primarily for purposes of evading regulation under the CROA.

In Credit Counseling Centers v. S. Portland, 814 A.2d 458 (S. C. Me. 2002), the Supreme Court of Maine denied state tax exemption to a credit counseling agency that provided significant benefits to creditors. Credit card companies commonly make payments to credit counseling agencies of a portion of the funds they receive from clients of the agencies. These payments are known as "fair share" payments and are a source of substantial funding for credit

counseling agencies. In this case, the credit counseling agency received 60 percent of its income from "fair share" payments from credit card companies, at the rate of 8.5% to 9% of debt payments.

Businesses are prohibited from cold-calling consumers who have put their phone numbers on the National Do-Not-Call Registry, which is maintained by the Federal Trade Commission ("FTC"). Nonprofit organizations are not subject to this rule. This registry was created by rules promulgated by the FTC and the Federal Communications Commission. See 16 C.F.R. section 310.4(b)(1)(iii)(B); 47 C.F.R. section 64.1200(c)(2).

Section 501(c)(4) of the Code describes, in relevant part, civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare.

Section 1.501(c)(4) of the regulations provides that an organization may be exempt as an organization described in section 501(c)(4) if it is not organized or operated for profit and is operated exclusively for the promotion of social welfare.

Section 1.501(c)(4)-1(a)(2) of the regulations provides, in relevant part, that an organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one, which is operated primarily for the purpose of bringing about civic betterments and social improvements. An organization is not operated primarily for the promotion of social welfare if its primary activity is carrying on a business with the general public in a manner similar to organizations, which are operated for profit.

In Rev. Rul. 65-299, 1965-2 C.B. 165, the Service recognized a credit counseling service (agency) open to the general public as exempt under section 501(c)(4) of the Code. The agency was incorporated as a nonprofit corporation to assist families and individuals with financial problems and to help reduce the incidence of personal bankruptcy. The Service maintained that the objective and activities of the agency contribute to the betterment of the community as a whole. The agency did not limit its services to those in need of such assistance as proper recipients of charity.

The agency employed specialists to interview applicants who are in financial difficulty, analyze the specific problems involved, and counsel on the payment of their debts. It arranged a monthly distribution to creditors on the debtor's ability to pay. Moreover, it communicated with creditors and, with the creditors' consent, set up plans that applicants agree to follow. It made its facilities available for debtors to make their monthly pro rata distributions to creditors. It made no loans to the applicants or negotiated on their behalf. It charged nominal fees for monthly prorating services, but charged no fees for the counseling services. The organization relied upon voluntary contributions from local businesses, lending agencies, and labor unions to cover its cost of operations.

Based on our analysis of the information provided in your Application and supporting documentation, we have concluded that you are neither properly organized nor properly operated under section 501(c)(3) of the Code. You fail the organizational test because your Articles of Incorporation do not specifically state that you are organized exclusively for charitable and educational purposes within the meaning of section 501(c)(3). You fail the operational test for a number of reasons. You have failed to establish that you are or will be operated for either a charitable or educational purpose. In fact, your file demonstrates that you operate for the substantial non-exempt purpose of operating a business. Another non-exempt purpose appears to be your operation to avoid regulation under the CROA. In addition, you have not shown that your income does not inure to any private individual. In addition, you have not shown that your operations will be exclusively charitable and educational rather than for the substantial private benefit of the for-profit companies, N and O, and their shareholders or managers or others with whom you conduct business. Finally, you also substantially benefit the credit card companies to whom your clients owe money because you function as a collection agent for those companies.

An organization seeking exemption must establish that it operates as a section 501(c)(3) organization. Denial of exemption may be based solely upon failure to provide information describing in adequate detail how the operational test will be met. Revenue Procedure 84-36, 1984-1 C.B. 541; American Science Foundation v. Commissioner, T.C. Memo. 1986-556; La Verdad v. Commissioner, 82 T.C. 215, 219 (1984); Pius XII Academy v. Commissioner, T.C. Memo. 1982-97.

Rev. Proc. 90-27, requires an applicant to submit sufficient information during the application process for the Service to conclude that the organization is in compliance with the organizational and operational requirements of section 501(c)(3) before it must issue a ruling. You failed to fully describe your activities as relates to the provision of proof that your counselors/account specialists are in fact certified and experienced as represented in some of your materials; substantial evidence that you will meet with clients on a regular, systematic basis to provide substantive counseling in credit matters; substantial evidence detailing how your seminars would be conducted including when, where, subjects to be discussed, and number of people you expect to attend.

You failed to provide information as to your actual or estimated change in the percentage of time dedicated to education and “client counseling services”; failed to indicate the specific hours in the day your counseling services are available; failed to provide specific details on how your website has changed in terms of providing “stronger emphasis on counseling and educational information”; failed to identify the individuals who produce your educational materials, and show proof of their credibility in producing these kinds of materials; failed to explain whether any of your employees, administrators, or others receive any fees or compensation for the production of your in-house “educational” materials; failed to provide proof of bonding and/or theft insurance for your operations; failed to indicate the amount of salary D and B are paid by N; failed to indicate whether D and B have an ownership interest in N; failed to explain why N was selected over other companies providing similar services; failed to indicate the amount of monthly fee to be paid to O; and failed to provide adequate information on your relationship with L and G, as requested in our letter to you dated August 9, 2004.

Because you failed to provide the requested information, you have not fully described the activities in which you expect to "engage, including the standards, criteria, procedures, or other means adopted or planned." See Rev. Proc. 90-27, supra. Thus, in accordance with the revenue procedure and the previously mentioned Tax Court cases, you have failed to provide sufficient information to adequately detail how you will satisfy the operational test. The Service may decline to issue a favorable ruling under these circumstances.

While you have not submitted sufficient information to support a favorable ruling, you have submitted sufficient information to conclude that the activities you plan to engage in will fail to meet the requirements of the operational test for the reasons explained below.

You have stated that your purpose is to "assist consumers with budget planning and credit counseling." Providing individual counseling to clients on credit matters may be educational or, if provided in a charitable manner, may be charitable within the meaning of section 501(c)(3). See, e.g., Rev. Rul. 78-99, 1978-1 C.B. 152 (individual and group counseling for widows based upon their ability to pay is an educational activity). You have not submitted sufficient documentation, however, that the counseling you do is either charitable or educational in the sense recognized by the law.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as operating exclusively for exempt purposes only if it engages primarily in activities that accomplish one or more of the exempt purposes specified in section 501(c)(3) of the Code. Providing services exclusively for the benefit of the poor, a recognized charitable class, furthers charitable purposes. For instance, counseling the poor about economics and personal finance can achieve an exempt purpose. See Rev. Rul. 69-441, supra.

You do not restrict your activities to the benefit of the poor. In fact, you have not represented in your Application, Articles of Incorporation, or elsewhere that your clients will come from low-income backgrounds. Moreover, you have not provided any substantial evidence (demographic studies, etc.) that you will serve, primarily, a specific, identifiable charitable class. An organization that is exempt because it provides services to the needy must have procedures in place that will ascertain whether each potential client is needy. You have demonstrated that you do not have these procedures. You have no standards because the DMP you offer is sold to anyone who has unsecured debt and is willing to purchase your services. No court or Service ruling has indicated that the sale of DMP's is a charitable activity. Since the sale of DMP's to the general public appears to be a substantial purpose of yours, we cannot conclude that you are operating for charitable purposes.

Further, based on the information you submitted, you have not established that you operate for educational purposes within the meaning of section 501(c)(3). Training an individual to develop his capabilities or instructing the public on subjects useful to the individual and beneficial to the community are both educational purposes, recognized as exempt. See section 1.501(c)(3)-1(d)(3) of the regulations. Financial counseling could be carried out as an educational activity. Consumer Credit Counseling Service of Alabama, Inc. v. United States,

Rev. Rul. 69-441, supra. While education is a broad concept, the Service and the Courts require that some rigor must be evident. In St. Louis Science Fiction Limited, supra. the Court made it clear, by contrasting the applicant with Goldsboro, that an organization must have an educational program not a predominantly non-educational program with some random educational features.

The information you submitted provides no basis to conclude that you offer either education to the public on subjects useful to the individual and beneficial to the community or training to the individual. It is essentially devoid of any support that you provide education. The information you provided in support of your Application demonstrates that counseling activities and educating the public on credit issues are an insubstantial part of the activities you conduct. You have stated that you will provide 60% of your time for "education and counseling." However, you have provided no substantive details and information as to when, where, or how this "education and counseling" would be conducted. You have stated that you would employ individuals in counseling and education services. Although employees would appear to be a significant number, when you consider that you expect by the end of fiscal year to have approximately enrolled in your DMP program, this number is clearly insignificant. It seems unlikely, in view of the large number of clients likely to be serviced by you, how you realistically expect your small staff to provide any meaningful, substantive credit education to these clients. You have not shown that you dedicate any structured time or place for any meaningful, substantive counseling and education on credit matters. That you do not offer substantive "counseling and education" is reflected in the following statement: "Counselors are available over the phone or in person throughout the consolidation." This language clearly indicates that the enrollment of clients in DMP's is the primary task of a counselor, while education of clients on credit matters is a secondary task that can be made "available." There is no evidence that "education" of clients on credit matters is required or encouraged.

Moreover, you are using your employees in a deceptive manner in representing that your employees are "experienced" when in fact they are merely trained for intake processing of DMPs. You have provided no credible evidence that any of your employees have extensive "experience" in credit counseling or that they have passed the T examination, which you stated would be required of all employees. You have not shown that your employees are licensed, bonded or insured. The lack of credentials and low starting salary you propose to pay your employees does not support your assertion that they are highly trained and credentialed in seeking to perform their "counseling" duties. You have not provided information indicating the number of people you expect to attend any structured counseling sessions; and have not indicated the amount of time to be spent in "pure" counseling versus time spent in soliciting, convincing, enrolling, and referring clients to the debt management program. You have submitted no schedule of classes or seminars. Any information you have submitted about your potential educational activities is vague, self-serving and provided with no substantiation.

As you have evidenced in your proposed budgets, you have made no specific expenditures related to educational activities or programs that would indicate a substantial commitment to this particular activity. Your telephone "counseling" sessions are primarily dedicated to carrying-out your role as intake-administrator and facilitator to clients before they

enroll in a DMP. Thus, it would appear that your employees' primary duty and responsibility consists of marketing DMPs to as many clients as possible, rather than the provision of one-on-one "counseling" sessions or the provision of education to the general public on credit issues.

You have provided no information detailing how your seminars would be conducted including when, where, subjects to be discussed, and the number of people expected to attend. We note that financial and budgeting seminars are easily used to recruit potential DMP clients, thus, serving as a marketing tool for the promotion of your business. We also note that in your Application, you state that you will offer free "information manuals" to clients and the general public. However, you have provided no evidence that you have made "free" distributions of these materials to clients or the general public. You are unlike the organizations described in Consumer Credit Counseling Services of Alabama, Inc. v. United States, supra, Credit Counseling Centers of Oklahoma, Inc. v. United States, supra, and Rev. Rul. 69-441, supra. Those organizations provided information to the general public through the use of speakers, films, and publications on the subject of budgeting, buying practices, and the sound use of consumer credit. Unlike your activities, in those cases and the Rev. Rul., the community education and counseling assistance programs were the agencies' primary activities. You have submitted no evidence that you provide any similar information to the general public.

Also, in contrast to the organization in Consumer Credit Counseling Service of Alabama, you have not demonstrated the individual training content of your "counseling" sessions with your clients. In that case, counselors spent additional time in individual counseling concerning budgeting and the appropriate use of consumer credit to "debt-distressed" individuals and families. The professional counselors used only percent of their time for debt management programs. You have stated that your budget planning activities would amount to at least percent, more than the percent spent in CCCS Alabama. The information you provide your counselors seems entirely aimed at selling and servicing DMPs.

You operate in a manner that it is strikingly different from the charitable credit counseling organization described in Rev. Rul. 69-441. That ruling states:

> The organization did not charge fees for counseling services or proration services. The debtor received full credit against his debts for all amounts paid.

The organization in the revenue ruling assisted the debtor by using all of the debtor's funds to pay off creditors. You, on the other hand, charge your clients a fee and require a deposit equal to the scheduled monthly payment, which is refunded only upon written request, upon completion of the DMP.

An analysis of the information provided shows that you are operated primarily for the nonexempt purpose of operating a for-profit business. That your primary activity is to promote and to further your private business interests is reflected in the fact that the vast majority of your revenue will be derived from fees charged to clients enrolled in your DMP. Though you may view these fees as "voluntary contributions," we have determined that they are in fact fees received in exchange for the sale of a program-related service. Your proposed financial

information in your Form 1023 Application shows that for and , you will receive total revenue in the amount of and , in each respective year. You have provided no indication of how you will spend the substantial income you will be earning, including your projected excess of revenue over expenses. You indicated that proposed salaries for your employees is expected to be in and in . You informed the Service that most of your employees would be receiving salaries of approximately each. That you would pay your counselors less than (counselors receive a starting salary of) is troubling in light of the fact that your "primary" activity is supposed to be the provision of "counseling" to individuals and families with credit issues. This would appear to be a "pure" business decision, in that it indicates that your first priority, as reflected in the higher pay to technical, disbursement, and other employees, is efficiency in processing DMP's as opposed to the provision of "authentic" counseling services.

You have not provided any evidence that the fees to be charged to clients enrolled in your DMPs are any less than would be paid by individuals serviced by a for-profit credit counseling company. In Airlie Foundation v. Commissioner, supra, one of the factors considered in assessing commerciality was the extent and degree of below cost services provided. You provided no evidence that your clients ever receive free services, or can pay according to their ability. The fact that the vast majority of your clients will pay some amount of your requested "contribution" is evidence that your clients do not perceive these payments as voluntary. Moreover, your projected number of clients ( ) to be enrolled in your DMP program by the end of fiscal year , is clear evidence that you operate in the manner of a for-profit credit counseling. Also, the amount of revenue you expect to generate in and strongly suggests that you anticipate enrolling large numbers of individuals in DMPs.

We also note that the significant expected spike in DMP income from to , suggests that you will make an intense effort to enroll more clients, an effort more consistent with a for-profit credit counseling company. In an apparent effort to advance your sale of DMPs, you use your website to advertise the availability of your DMP program, and use language that is possibly misleading and at the least "puffery" in nature. This is reflected in the following statement

You have even made the following representation to potential clients:

That you will not allow a client to make a lump-sum pay-off of his or her debt to creditors shows that you are not concerned with a client quickly dispensing with debt, as this would obviously impact your ability to make more money over the long-term. Thus, you put your private business interests before the personal interests of clients in not allowing the client to pay-off his or her debt immediately.

Moreover, you apparently offer clients the opportunity to purchase a The plan claims to be underwritten by U, and only costs per month. It will supposedly pay off debt up to , in the event of death, disability or unemployment. You have not provided a copy of the plan, so that we could determine if in fact it is a legitimate

plan. It would appear that clients, who already have serious debt problems, could be placed in an even worse financial position if the plan is not legitimate. If you in fact make money from this arrangement, it would be consistent with your operation as a for-profit credit counseling business, trying to maximize its business opportunities. That the client services agreement allows you the discretion to release his or her financial information to third parties, could mean that this information may be sold to other businesses without the client fully understanding the possible negative consequences. Furthermore, the agreement allows you to increase the monthly amount paid by the client, if the creditors desires more than the proposed DMP payment. This would obviously allow you to increase the amount of revenue you receive through the DMP program.

Thus, it would appear that you are operated to make a profit, not to give-away free or reduced priced services to the poor. That you may or may not immediately make a profit would not be conclusive proof that you are not operating a business venture. According to your proposed budgets in your Application, you expect to have revenue in excess of expenses in and . You have provided a copy of your business license issued for by the city of W.

Unlike the agencies in Consumer Credit Counseling Services of Alabama, you receive no support from contributions from the general public, government or private foundation grants, or assistance from the United Way. In fact, you have no fundraising program to solicit such contributions. According to your proposed budgets for and , you plan to receive all your revenue from fees from setting up and processing clients' DMPs and fair share payments from creditors. For-profit business enterprises are supported by fees paid by those who receive services. While charitable institutions often do provide services to individuals, the cost is generally subsidized by contributors who do not receive anything in return. In B.S.W. Group, Inc. v. Commissioner, *supra*, the court cited lack of solicitation and sole support from fees as negative factors for exemption. See also, Easter House v. United States, *supra*.

You have not shown that revenue from operation of your DMP, is used for any purpose other than to cover operating expenses. Like any ordinary commercial business, your expenditures are almost exclusively to pay salaries, office expenses, and processing costs to N, O, and other for-profit service providers. In fact, a large proportion of your revenue will be expended to pay DMP processing costs and to purchase leads. You have not provided any information to indicate that you plan to dedicate any specific revenue to activities involving educational and/or charitable programs. In having a paid staff with no volunteer help, and having no direct expenditures for charitable and educational purposes, you are similar to the organization described in Easter House v. United States, supra, where the court determined that the organization was not exempt because its conduct of adoption services activity was in furtherance of a non-exempt commercial purpose.

Your substantial expenditures for the purchase of leads is clear evidence that you aggressively seek out clients in order to expand and grow your business. That you purchase leads per month to call potential clients shows that the primary thrust of your operations is the enrollment of as many clients as possible in DMP's. The significant amount of time and revenue dedicated to your leads operation substantially diminishes the resources available to

provide for the provision of substantive, "authentic" credit counseling to individuals and families. You also seek referrals from internet financial sites, publicize your services through financial and budgetary seminars, and advertise on your own website. Therefore, you will promote and attempt to sell your services in ways that are typical for any for-profit business.

The facts in your case also show that your activities serve to promote the private business interests of N, rather than to promote the public interest. Your agreement with N allows it to perform all services related to your staffing, training, advertising, software, database management and website development, during your "start-up" phase of operations. You do not indicate how long you expect your "start-up" phase to last. The agreement is clear, however, in stating that N will provide services for an "initial term of ( ) months." The agreement further states that you and N, may by mutual agreement, at anytime extend the initial agreement. Therefore, the agreement could possibly continue ad infinitum. The agreement appears to be quite favorable to N in that it allows N to invoice you periodically for

That the agreement provides you with very little control over the potential costs of the services provided by N, indicates that N has wide latitude and control over the amount of fees that you will eventually pay for its services.

N's control is further reflected in the fact that it retains

Thus, N's control over the property rights in the database, as with control over the costs of services, is expansive, far-reaching and seemingly unfettered. The conditions in this agreement would clearly promote the present and future financial private business interests of N, to the considerable expense of your organization. Thus, as in est of Hawaii, 71 T.C. 1067 (1979), certain aspects of your business operation are controlled to a certain extent by a for-profit company. The essence of the agreement with N allows it to dictate charges and methods of operation, and assures long-term financial support for N.

Your activities also would promote the private business interests of O, rather than promote the public interest. Under your agreement with O, O would have the authority, with the client's authorization, to "debit the client's checking or savings account for the amount owed to you by the client." Furthermore, the agreement gives O the power to debit your account for any services charges owed to it. The agreement even allows for modification of the charges "upon written notice." Therefore, O, like N, seemingly has very broad latitude in deciding the amount of its monthly charge to you. This is especially the case given the fact that you have not indicated what O is likely to charge you for its services. There is no way to know whether these fees would be at or above market rates. In view of the fact that O is a for-profit business, it is likely to charge you, the highest possible fees for the services rendered to you. Thus, your relationship clearly serves to promote the private for-profit business interests of O.

Because the largest share of your operating expenses is budgeted to pay for services

rendered to you by back-end service providers, such as N and O, it appears that the potential financial benefit to be bestowed on N and O far exceeds any potential public benefit. Furthermore, you would also benefit in your business operation in that your proposed financial information for , shows that you will receive "fair share" payments from creditors amounting to and , in each respective year. You are like International Postgraduate Medical Foundation, *supra,* where an alleged exempt organization was found to have been established to provide business to a travel agency owned by the same individual. Other cases on point are P.L.L. Scholarship and KJ's Fundraisers, *supra*, in which charitable fundraising was conducted on the premises of for-profit businesses in such a way as to benefit the businesses by attracting customers. Even though the organizations provided some scholarships, the court found that they had a substantial nonexempt purpose of promoting for-profit businesses. Based on the information you submitted, we conclude that a substantial purpose of your creation is to provide business to N, O or other back-end providers.

Your apparent attempt to avoid regulation under the CROA also indicates that you are operated for a substantial non-exempt purpose. See 15 U.S.C. section 1679 et seq. This statute imposes restrictions on credit repair organizations, including forbidding advance payment before services are fully performed. 15 U.S.C. section 1679b. Section 501(c)(3) organizations are by definition excluded from regulation under the CROA. As stated above, the courts have interpreted the CROA so as to apply to the activities of credit counseling organizations.

The information you have provided can only be interpreted as evidence that you charge an advance fee, a practice forbidden to for-profit organizations under the CROA. Your Debt Management Agreement provides a fee structure of up to per month per account plus a first payment or "contribution" for operational costs. Your debt management agreement does not refer to an option for waiver of fees. You have not provided any data on the number of clients that have not paid the initial "contribution." Only tax-exempt charitable organizations are permitted under the CROA to charge any of these advance fees. Based on the information you have submitted, it appears that you are seeking exemption as an charitable organization because your activities would not otherwise be permitted a commercial for-profit organization. Moreover, your relationship with N shows that you are operating as a front for N, in that your having exempt status would allow N to collect fees from clients that are funneled through your operation. In this regard, you are similar to the organization described in FTC v. Gill, supra, in that one of your purposes appears to be evading regulation under the CROA.

An organization cannot prove that it is entitled to exemption where one of its purposes is the avoidance of regulation. See The Foundation Church of Scientology v. U.S., 188 Ct. Cl. 490, 506 (1969). Since that it is one of your purposes, you are not entitled to exemption.

In addition to operating for substantial non-exempt purposes, you also benefit the private interests of a select few. Under section 1.501(c)(3)-1(d)(1)(ii) of the regulations, an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public benefit rather than a private interest. An organization must establish that it is not organized or operated for the benefit of private interests, such as designated individuals, the

creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests. You failed to submit sufficient information to show that you do not substantially benefit the private interests of N, O, its shareholders or managers or others.

You also provide substantial private benefit to credit card companies in a manner similar to the organization in Credit Counseling Centers v. S. Portland. Fair share is commonly defined as "that amount the organization receives from the creditors for each payment remitted to them." In the absence of any charitable or meaningful educational activities you are operating as a collection agency for these companies. The "fair share" paid by the credit card companies would undoubtedly result in significant savings over the possible costs of not recovering any of the unpaid debt owed them. Thus, these companies clearly realize substantial financial benefits through their business relationship with you.

We note that none of the members of your Board of Directors has any apparent extensive work experience or educational background in nonprofit "credit counseling." It would seem that, in order to achieve exempt purposes, you would have at least some individuals on your Board possessed of prior experience and education, on financial and credit issues that impact the lives of individuals and families who find themselves in debt. Moreover, because D and B are employees of N, and serve on your Board, they would have an inherent and obvious conflict of interest in voting on any financial matters that relate to N.

Based on our analysis of your actual and proposed activities and, in light of the applicable law, we have determined that you are not operated for exempt purposes. Rather, you are, primarily, operated for the non-exempt purpose of furthering your business interests, and those of N and O, through the marketing and sale of DMPs to the general public. Any activities involving "authentic" credit counseling provided to a genuine charitable class, along with the provision of credit education to the general public, would be purely incidental to your predominant non-exempt purpose of operating and carrying-on an ordinary for-profit "credit counseling" business.

Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code and you must file federal income tax returns.

We note that, in view of the holding in Rev. Rul. 65-299, supra, along with the Code and regulations, we do not believe that you qualify for exempt status under section 501(c)(4). Unlike the organization in Rev. Rul. 65-299, your activities do not contribute to the betterment of the community as a whole, rather your activities serve to further the nonexempt purpose of operating a for-profit credit counseling business.

Contributions to you are not deductible under section 170 of the Code.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted.

You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

In the event this ruling becomes final, it will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

If you decide to protest this ruling, your protest statement should be sent to the address shown below. If it is convenient, you may fax your reply using the fax number shown below. If you fax your reply, please contact the person identified in the heading of this letter by telephone to confirm that your fax was received.

Internal Revenue Service
TE/GE (SE:T:EO:RA:T:4)

1111 Constitution Ave, N.W.
Washington, D.C. 20224
Fax: (202) 283-8937

If you do not intend to protest this ruling, and if you agree with our proposed deletions as shown in the letter attached to Notice 437, you do not need to take any further action.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Lois G. Lerner
Director, Exempt Organizations
Rulings & Agreements

Enclosure:
Notice 437